



Irving Trust

Irving Trust Company
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Economic Research &
Planning Division

Friday
(Noon)

Aug. 14, 1981

Financial markets were extremely nervous this week, with participants awaiting major economic data releases late in the week, and government securities dealers eyeing the approaching Monday settlement date for the Treasury refunding issues. Adding to the disquiet was a slight degree of firmness in the Federal funds rate on Wednesday and Thursday, together with substantial writing of CDs by major banks whenever CD rates showed any inclination to decline.

Nevertheless, the funds rate is trending down gradually, and before long that will pull other short-term rates along for at least modest declines. The key reason is the recent effort by the Federal Reserve to reduce pressures on bank reserves positions, as revealed in the approximately \$1 billion decline of net borrowed reserves since late June. In addition, the pattern of open market operations this week—including an outright purchase of Treasury bills on Wednesday and four-day repurchase agreements on Thursday—also suggests a strong interest by the Fed in easing pressures, particularly in view of the possibility that float may still increase quickly if major difficulties arise as a result of the air traffic controllers' strike. Finally, the lower levels of borrowing by banks so far this quarter suggest that a great many have yet to use the four "tickets" allowed the larger banks for borrowing at the basic 14% discount rate. As the quarter end approaches, attempts by banks to use their borrowing allotments fully should compound the downward pressure on the funds rate.

The Federal Open Market Committee meets on Tuesday next week against a background of continued evidence of slowing of inflation pressures, as well as sluggish economic activity. Growth of M-1B is also following a sluggish pattern, though M-2 is very strong. However, it should be recalled that, during the first half of this year, about 70% of the gap between M-1B and M-2 growth was accounted for by expansion of money market mutual fund shares, while their proportion of the growth of July's M-2 (to be reported tonight) should be even higher. Of course, the Fed is justifiably concerned about the (largely unknown) transactions component of money fund shares, since its expansion artificially depresses M-1B. Nevertheless, the Fed at this stage cannot be wholly aloof from the strains emerging in the financial system—graphically symbolized by the anemic growth of small time deposits and savings accounts, the main funds source for thrift institutions. That part of M-2, at least, is withering. While it would be rash to expect a panicky reaction by the Fed, before long it will respond, and another move toward ease could come as a result of next week's meeting.

As things stand now, net borrowed reserves have already declined so far that there is not much scope for further ease without a reduction of the discount rate. While that is not an immediate probability, it appears likely within a few weeks.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.



	8/14/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.50%	20.50%	11.00%
Effective since	7/8/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	10.00
Federal Funds	17.50	18.75	9.00
Repurchase Agreements	17.25	18.50	8.38
U.S. Treasury Issues			
Bills			
3 months	16.18	16.29	8.54
6 months	16.96	16.96	8.96
1 year	16.63	16.66	8.99
Coupons			
2 years	16.07	16.00	10.08
4 years	15.48	15.65	10.14
7 years	14.95	15.05	10.63
10 years	14.65	14.84	10.89
Long Bond	13.85	14.10	10.88
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.10	18.25	9.45
3 months	18.05	18.20	9.60
6 months	18.05	18.05	10.00
1 year	17.50	17.20	10.25
Banker's Acceptances			
1 month	17.85	18.25	9.30
3 months	17.90	18.25	9.60
6 months	17.95	18.15	10.00
Eurodollar Deposits			
1 month	18.38	19.00	9.50
2 months	18.50	19.00	10.00
3 months	18.63	19.00	10.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.63	18.25	8.88
1 month	17.63	17.75	9.13
3 months	16.50	16.50	9.00
Bank Holding Companies			
1 month	17.50	17.75	9.00
Dealer Placed:			
3 months	17.63	18.00	9.13
New AA Corporate Utility Bond	16.85	17.00	12.75
Tax Exempt			
6 month Project Notes	8.35	7.85	4.60
1 year AAA Bond	8.40	8.40	5.10
5 year AAA Bond	8.90	9.00	5.45
20 year AAA Bond	11.00	10.25	7.80

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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